

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FAROQ H. ALGABYALI D/B/A	:	DETERMINATION
BROADWAY 24 HOUR EXPRESS	:	DTA NO. 818434
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period March 1, 1995 through August 31, 1997.	:	

Petitioner, Faroq H. Algabyali d/b/a Broadway 24 Hour Express, 2170 Broadway, New York, New York 10024, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1995 through August 31, 1997.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on December 13, 2001, at 10:30 A.M., with all briefs due by May 17, 2002, which date began the six-month period for the issuance of this determination. Petitioner appeared by Jeffrey H. Ziffer, CPA. The Division of Taxation appeared by Barbara G. Billett, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether, as a result of an audit, the Division of Taxation properly determined additional sales tax due.

II. Whether petitioner established reasonable cause for abatement of penalties.

FINDINGS OF FACT

1. Petitioner's principal business activity is a retail convenience store located at 77th Street and Broadway in Manhattan, known as Broadway 24 Hour Express. It is located in an upscale residential neighborhood and its principal products include beer, soda, candy, coffee, newspapers, magazines, paper goods, cigars, cigarettes, lotto and other sundry items. During the periods in issue, the business was open 24 hours a day.

2. Petitioner was registered as a vendor for sales tax purposes and filed New York sales tax returns for the audit period, March 1, 1995 through August 31, 1997. Petitioner reported as gross and taxable sales the following amounts for the audit period:

Period Covered by Return	Gross Sales Reported	Taxable Sales Reported
March 1, 1995-May 31, 1995	\$35,051.00	\$3,153.00
June 1, 1995-August 31, 1995	47,321.00	4,671.00
September 1, 1995-November 30, 1995	52,693.00	8,534.00
December 1, 1995-February 28, 1996	53,121.00	8,334.00
March 1, 1996-May 31, 1996	53,627.00	8,421.00
June 1, 1996-August 31, 1996	51,811.00	8,576.00
September 1, 1996-November 30, 1996	50,741.00	7,921.00
December 1, 1996-February 28, 1997	51,371.00	8,061.00
March 1, 1997-May 31, 1997	53,723.00	8,117.00
June 1, 1997-August 31, 1997	50,714.00	7,916.00

3. The Division of Taxation ("Division") commenced a sales tax audit of petitioner's business, and Mr. Henry Li, of the Department of Taxation and Finance, sent an appointment letter to petitioner dated November 19, 1997, in which he requested all books and records pertaining to petitioner's sales and use tax liability for the period under audit, March 1, 1995 through August 31, 1997. Petitioner was asked to produce financial statements, journals,

ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, federal income tax returns, and exemption certificates. An appointment for a field audit was established at petitioner's place of business on December 17, 1997 at 10:00 A.M.

4. On November 24, 1997, petitioner's former representative, Tony Antonious, contacted Mr. Li, and on December 8, 1997, the Division's auditor and his team leader had a meeting with petitioner's representative. Mr. Antonious informed Mr. Li that petitioner's books were grossly incomplete and that he had initiated a request to petitioner's suppliers for a record of purchases for the audit.

5. On December 18, 1997, Mr. Li and his team leader observed the operations at petitioner's place of business and made some notes about products and prices. Mr. Li met again with Mr. Antonious in February 1998 and received no records. As a result of petitioner's failure to produce cash register tapes, sales invoices, daily sales records, purchase invoices, bank statements and cash disbursements journals, the Division's auditor determined that there were insufficient records to perform a detailed audit.

6. Thereafter, Mr. Li scheduled a more detailed observation test to record the sales of approximately a 13-hour period, from 7:00 A.M. to 8:00 P.M., on March 27, 1998. On this date, Mr. Li and his team of observers recorded each item sold and the price of the item. If the item was nontaxable, it was noted on the work paper. The Division observed and recorded sales between 7:00 A.M. and 8:00 P.M. in the amount of \$1,265.41, with \$167.96 as nontaxable, leaving \$1,097.45 as taxable sales (or 86.73% of gross sales). The Division added to the gross sales for the stated 13-hour period 25% of gross sales (\$316.35), to represent an estimate of sales for the remaining 11 hours that petitioner was also open. The Division based this estimate on its experience in conducting audits of this type and the fact that the evening and overnight period

would produce substantially fewer sales for essentially the same number of hours. The resulting estimated gross sales per day was \$1,581.76 (\$1,265.41 + \$316.35). To calculate gross sales per week, the \$1,581.76 was multiplied by 7 to result in \$11,072.32. This amount was multiplied by 13 weeks in a quarter, to result in gross sales per quarter in the amount of \$143,940.16. Since the Division determined that the taxable percentage of all sales was 86.73%, the \$143,940.16 was multiplied by 86.73%, resulting in computed taxable sales per quarter in the amount of \$124,839.30. Petitioner was given credit for the taxable sales as reported (*see*, Finding of Fact “2”), resulting in additional taxable sales. The tax rate of 8.25% was multiplied by additional taxable sales to compute tax due on additional taxable sales in the amount of \$96,911.62. Penalties and interest were computed upon this amount.

7. Following the observation test, Mr. Li scheduled another appointment with petitioner’s representative, and met with him on April 8, 1998. Mr. Antonious executed a consent extending the statute of limitations for the assessment of sales and use taxes for the period March 1, 1995 through August 31, 1997 to any time on or before June 20, 1999. Another meeting took place with petitioner’s representative on June 10, 1998, and no additional records were presented. During July and August 1998, the Division was unable to reach Mr. Antonious by phone and Mr. Li made final computations and closed the case.

8. The Division issued to petitioner, a Notice of Determination dated October 19, 1998, which assessed total taxes due of \$91,911.62 for the period March 1, 1995 through August 31, 1997 (Assessment ID L-015627931-8), plus penalty and interest as follows:

Tax Period Ended	Tax Amount Assessed	Interest Assessed	Penalty Assessed	Balance Due
5-31-95	\$ 10,039.10	\$ 4,928.29	\$ 4,015.64	\$ 18,983.03
8-31-95	9,913.86	4,426.51	3,965.55	18,305.92

11-30-95	9,595.16	3,875.19	3,838.07	17,308.42
2-29-96	9,611.66	3,488.51	3,844.67	16,944.84
5-31-96	9,604.49	3,095.95	3,841.80	16,542.24
8-31-96	9,591.70	2,714.00	3,836.68	16,142.38
11-30-96	9,645.74	2,364.60	3,858.29	15,868.63
2-28-97	9,634.19	2,012.07	3,660.99	15,307.25
5-31-97	9,629.57	1,644.35	3,370.35	14,664.27
8-31-97	9,646.15	1,330.20	3,086.77	14,063.12
Totals	\$ 96,911.62	\$ 29, 899.67	\$ 37,318.81	\$ 164,130.10

9. A conciliation conference in the matter was conducted on November 23, 1999, and by a Conciliation Order dated January 19, 2001 (CMS No. 171397), the statutory notice was sustained.

10. Petitioner's representative at the hearing, Jeffrey Ziffer, CPA, indicated that Mr. Algabyali was out of the country with an infirm wife. There was no information provided as to his date of possible return from Yemen to the United States and no records submitted at hearing, or thereafter. Petitioner was provided an additional 30-day continuance to produce records and request the hearing be reconvened. Petitioner did not produce any records and did not request that the matter be reconvened for any additional testimony or submission of evidence.

SUMMARY OF THE PARTIES' POSITIONS

11. Petitioner's representative asserts that the audit produced unreasonable results since the observation test was performed on a Friday, the busiest day of the week; the test did not represent the business activity in general; and the overnight business estimated at 25% of gross sales for the 13-hour period was too high, suggesting that 10 to 15% was a more reasonable

estimate. Petitioner maintains that the tax, penalty and interest as assessed creates a severe financial hardship if upheld.

12. The Division argues that petitioner failed to produce any sales records and many other pertinent documents to enable an audit to be conducted. Having established the records were insufficient, the Division properly resorted to an indirect method of audit, in this case using an observation test, whereby the Division observes the actual operations of petitioner's business for a stated period of time and estimates sales and use taxes due on that basis. The Division concedes that its method of audit must be reasonable, but it asserts that it is not required to utilize the most exact method of audit, and that petitioner's arguments concerning the date of the study or the estimates applied, without more, are not enough to meet petitioner's burden of showing that the audit was irrational. On the issue of reasonable cause for abating the penalties, the Division argues that petitioner failed to carry his burden of proof that the audit method was unreasonable or that the determination was erroneous, such that abatement of penalties would be appropriate relief.

CONCLUSIONS OF LAW

A. Under Tax Law § 1135(a), "[e]very person required to collect tax shall keep records of every sale . . . in such form as the commissioner of taxation and finance may by regulation require." These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request (Tax Law § 1135[e]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are "sales slip, invoice, receipt, contract, statement or other memorandum of sale, . . . guest check, . . . cash register tape and any other original sales document" (20 NYCRR 533.2[b][1]).

In this case, petitioner produced no records, with the exception of sales tax returns, either on audit, during the hearing or post-hearing when provided additional time to do so. Petitioner did not produce any cash register tapes, sales invoices, bank statements or any original sales documentation to verify the amount of sales for the period in question. Petitioner did not provide anything that could be construed as a daily sales record. Thus, the Division made a proper determination that petitioner's records were inadequate for purposes of conducting a complete and accurate audit (Tax Law § 1135; 20 NYCRR 533.2).

B. There is no dispute that the audit methodology utilized in this matter was an indirect methodology not based on the books and records of petitioner. In order for the Division to utilize an indirect methodology, it must show that it made an adequate request for books and records for the entire audit period (*see, Matter of Christ Cella v. State Tax Commn.*, 102 AD2d 352, 477 NYS2d 858), and that it reviewed the records provided in order to determine that the records were inadequate for the purposes of conducting a complete audit (*see, Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978).

The original appointment letter sent by the Division to petitioner constituted an adequate request for books and records and covers the entire audit period in issue. This was followed by several other requests for records, telephone conversations and messages discussing the providing of records and meetings wherein records were requested. No records were provided by petitioner. Without such records, there are significant questions raised about the reliability of petitioner's methodology of recording its business transactions for sales tax reporting purposes. Therefore, it was acceptable for the Division to calculate petitioner's tax liability based on estimated or indirect audit methods.

C. Pursuant to Tax Law § 1132(c)(1), petitioner bears the burden of proving by clear and convincing evidence that the tax assessed was erroneous (*Matter of Rizzo v. Tax Appeals Tribunal*, 210 AD2d 748, 621 NYS 2d 115; *Matter of Mobley v. Tax Appeals Tribunal*, 177 AD2d 797, 799, 576 NYS 2d 412, *appeal dismissed* 79 NY2d 978, 583 NYS2d 195; *Matter of Surface Line Operators Fraternal Line Organization v. Tully*, 85 AD2d 858, 446 NYS2d 451). Furthermore, a presumption of correctness attaches to a notice issued by the Division, and the taxpayer must overcome this presumption (*see, Matter of Suburban Carting Corporation*, Tax Appeals Tribunal, May 7, 1998, citing *Matter of Tivolacci v. State Tax Commn.*, 77 AD2d 759, 431 NYS2d 174; *Matter of Leogrande*, Tax Appeals Tribunal, July 18, 1991, *confirmed* 187 AD2d 768, 589 NYS2d 383, *lv denied* 81 NY2d 704, 595 NYS2d 398).

D. The Division may resort to an estimated or indirect audit method to calculate sales tax due where a taxpayer has failed to present books and records adequate for the Division to conduct a detailed audit (*see, Matter of Urban Liquors v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138). While the method chosen by the Division must be reasonable (*see, Matter of House of Audio of Lynbrook*, Tax Appeals Tribunal, January 2, 1992) and reasonably calculated to reflect the taxes due (*see, Matter of W.T. Grant v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75; *Matter of Ristorante Puglia, Ltd. v. Chu*, 102 AD2d 348, 478 NYS2d 91), it need not be exact (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, 177, *affd* 44 NY2d 684, 405 NYS2d 454) and the auditor is given considerable latitude in devising an audit method (*Matter of Grecian Square v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

In the present case the auditor, having no sales records available, chose to conduct an observation test, which observes the actual business operations at the location of petitioner's

business and records sales as they take place over a stated period of time. From such information he calculated the total amount of additional taxable sales (*see*, Finding of Fact “6”). The estimate of 25% used by the Division to account for the late evening and early morning hours of operation was based upon prior audit experience of similar establishments and is reasonable. Petitioner provided no basis for such percentage to be reduced to either 10 or 15%. Likewise, other than the mere allegation that a Friday observation test was not representative of petitioner’s general business, no proof was provided that another day should have been selected. Sufficient evidence exists in this record to determine that the Division established a rational basis for this audit (*Matter of Grecian Sq. v. New York State Tax Commn.*, *supra*). Therefore, it was incumbent upon petitioner to show by clear and convincing evidence that the audit method was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679, 681). Inasmuch as petitioner produced no such evidence, petitioner has not met its burden of proving that the Division’s determination of tax due was incorrect or that the audit method was unreasonable.

E. In addition to the taxes assessed, petitioner was also assessed penalties under Tax Law § 1145(a)(1) for failure to properly pay any tax imposed under Articles 28 and 29 of the Tax Law, and for failure to report and pay sales tax in an amount in excess of 25% of the amount required to be shown on the return. Tax Law § 1145(a)(1)(iii) and (vi) provide that if the failure or delay was due to reasonable cause and not due to willful neglect, penalties and additional interest shall be abated. Petitioner has not established reasonable cause for abatement of penalty on any basis. Furthermore, the circumstances of this case indicate a lack of good faith, which negates any finding of reasonable cause and the absence of willful neglect (*see*, 20 NYCRR former 536.5[d][1]).

F. The petition of Faroq H. Algabyali d/b/a Broadway 24 Hour Express is hereby denied and the Notice of Determination dated October 19, 1998, bearing assessment identification number L-015627931-8, is sustained.

DATED: Troy, New York
November 7, 2002

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE